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C O N F I D E N T I A L SECTION 01 OF 02 BRASILIA 001804

SIPDIS

DEPARTMENT FOR WHA/BSC
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TREASURY FOR SEGAL, CRUZ
FEDERAL RESERVE FOR ROBATAILLE

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TAGS: EFIN ECON BR
SUBJECT: IMF QUESTIONS NEED FOR NEW IMF PROGRAM IN 2004

Classified By: Acting EconCouns David Edwards. Reasons: 1.5 B and D

¶1. (C) Summary. Rogerio Zandamela, IMF Resident Representative in Brazil, told econoff that Anne Krueger, the IMF's Deputy Managing Director, is not interested in renewing the IMF stand-by arrangement when it expires at the end of the year. Instead, she prefers to declare victory with the current successful program and wait in reserve in case needed again. Zandamela added that he has his doubts about how a follow-on program would be structured. He said the next key steps for restoring confidence are structural reform, and he believes that an IMF program with significant structural reform commitments would generate political opposition and be counter-productive. End summary.

¶2. (SBU) In a June 3 meeting with IMF Resident Representative Rogerio Zandamela, econoff asked whether Brazil's IMF program would be renewed when it expires at the end of the year. (Note: When an IMF mission visited Brazil in early May for the third review, a local paper carried a story that the GOB had already decided not to renew the program, which was quickly denied by the Ministry of Finance. Later, when Anne Krueger, the IMF's First Deputy Managing Director, visited Brazil on May 19-20, she told the media that the question of renewing the agreement had not been discussed with the GOB.)

¶3. (C) Zandamela said the there had been internal IMF discussions about a follow-on program during the May 19-20 visit. Anoop Singh, Director of the IMF's Western Hemisphere Department, had accompanied Krueger and had been interested in exploring another IMF program. However, according to Zandamela, Krueger's initial reaction was negative. Krueger evidently said that the IMF should declare its current program a success and when it is over, step to the side and be available to help when and if necessary.

¶4. (C) Econoff asked if the GOB had the resources to repay its current IMF obligations without a new IMF agreement, and how the market would react if there were no IMF program. Zandamela said that gross reserves are high enough that Brazil could repay its obligations and still have a cushion, particularly if the GOB continues to issue bonds in the international market. (Note: Gross reserves were $43.3 billion as of June 6, while net reserves (minus IMF funding) are approximately $17.0 billion.)

¶5. (C) Regarding the private sector reaction, Zandamela said that he is not concerned. He continued that the key next step for the government is implementing its reform program (notably tax and pension reform, but also Central Bank autonomy and bankruptcy law reform). Featuring structural reform in an IMF program would be difficult and maybe counter-productive, he said. The administration cannot guarantee that congress will act on its reform proposals, and an IMF program conditioned on congressional action would probably generate political resistance in congress. (Typically, in Brazil's IMF programs, the administration commits to present legislation to congress but is silent on the question of approval.) Therefore Zandamela has his doubts as to what a notional next IMF program should look like.

¶6. (C) Econoff asked whether the IMF would consider a monitoring program in the absence of a formal stand-by arrangement. Zandamela said that he doubts the GOB would submit itself to a special review regime without the financial support of a regular program, given that the IMF missions are very time-consuming for the GOB. He added, though, that even without an IMF program, the Fund would undertake twice-yearly reviews, compared to four times a year under a stand-by program.

¶7. (C) Zandamela cautioned that it is too soon to talk about a "virtuous circle." However, he added that by the end of the year the government's economic policies, combined with falling inflation, may open the way for a cycle of growing confidence, falling inflation, lower interest rates, accelerating economic growth, and reasonable capital inflows.

¶8. (C) Comment. It's a bit early to make any judgment on whether Brazil should renew its IMF program at the end of the year, but Krueger's and Zandamela's comments provide a useful perspective on why a program may not be necessary. In general, Zandamela is on target in his assessment that Brazil's economic success depends far more on GOB action rather than an IMF program. However, we are less sanguine than Zandamela about market confidence in the absence of an IMF program, since a program would provide a buffer against balance of payment pressure as well as valuable benchmarks to measure the government's macroeconomic effort.

Hrinak